DOW THEORY LETTERS INC.

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36 Letters per Year — $75 Annually

Registered with the Securities Exchange Commission

May 22, 1970 Letter 462

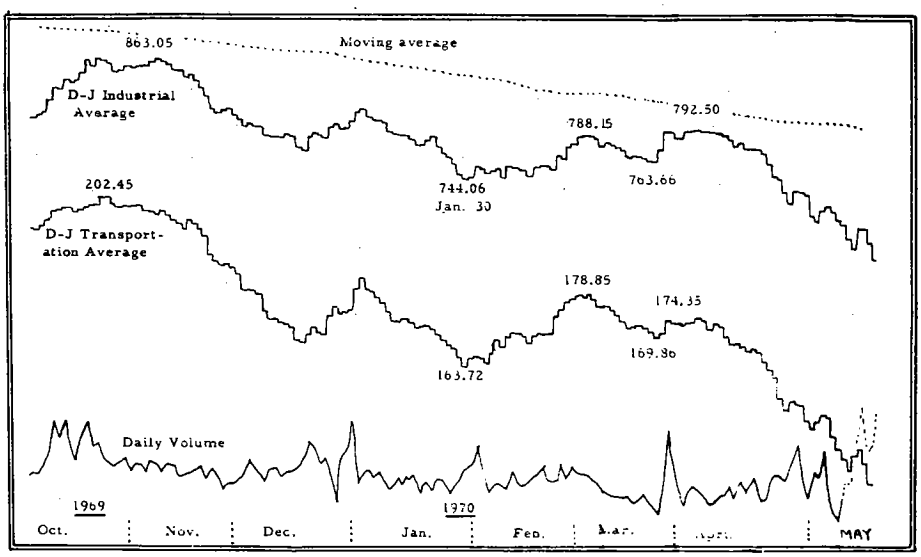
THE MARKET: The great 1949-1966 bull market topped out in February, 1966. I have spent four long years since then telling subscribers (using every method I knew) that it was vital to get out of stocks and in a cash position (with a small gold hedge). All during late-1966, 1967 and 1968 it appeared as if the bull was "reviving". I continued to insist that the rally following the first 1966 drop to 744.32 was a deceptive upward correction in a primary bear market.

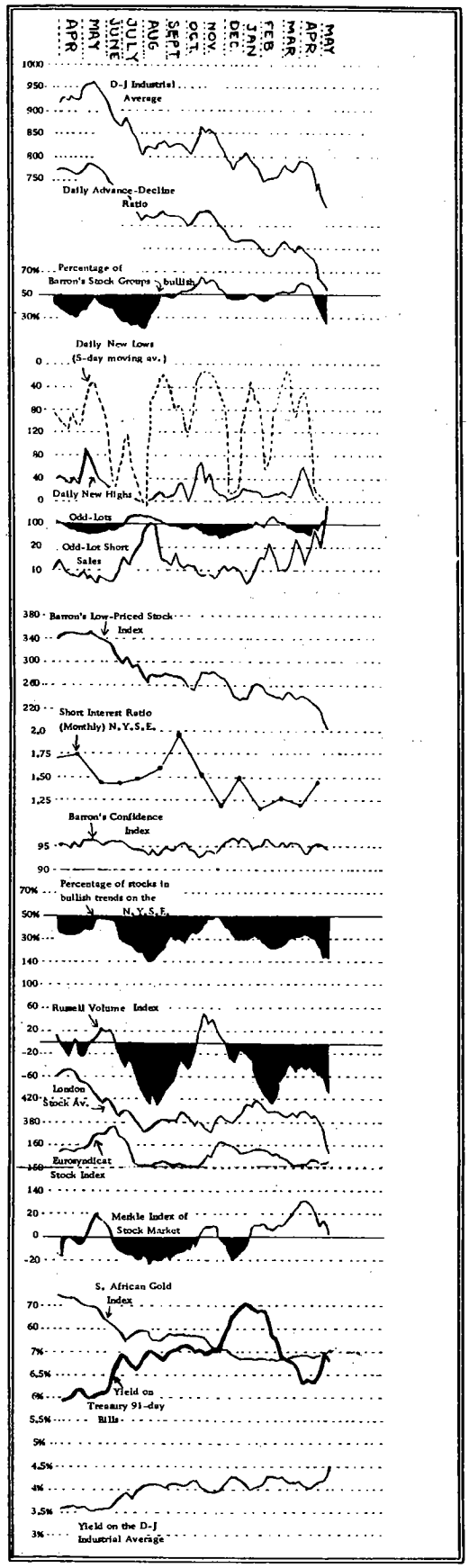
Then during late-1968, all through 1969 and up to the present the stock market began "unraveling". Stock after stock tumbled, sank or collapsed to lower levels. On May 7 all three D-J stock Averages (Industrials, Rails, Utilities) together with the D-J 40 Bond Average smashed to new lows, the first time this has occurred since December, 1969. The impact of the barrage of new lows in the leading indicators could almost be "felt". With the Industrial Average under 700, with the Transportation Average having almost cut itself in half (figuring from the 1969 high of 279.88), with the Utility Average just above 100 (it has not been under 100 since 1961), it was obvious that the back of the market was broken.

The week ending May 15 represented the seventh consecutive "down-week" for the Dow. This sorry performance has only one previous parallel in history, the eight-consecutive weeks of decline during early 1932. Again, the week ending May 15, 1970, saw all 34 of Barron's stock groups decline without a single advance. This is a rare occurrence, indicating extraordinary downward compression. The last time all the Barron's groups were minus was during the week ending January 30, 1970. This was followed by a temporary rally of 48 Dow points (on a closing basis), and then a smash to new lows.

The losses in stocks has been all-encompassing and tragic. The over-the-counter market has been chaotic, the Amex shares have crumbled, the N.Y.S.E. shares are in virtually every stage of collapse, and even the thirty Dow stocks, these outstanding blue-chips which comprise perhaps 25% of the value of the N.Y.S.E. listings have been battered to levels not seen in years.

To illustrate the damage which has been inflicted on the 30 Dow stocks, I include this listing on page 2 of the 30 Dow issues together with the all-time





highs (and the dates that those highs were established) together with the recent May 15 lows and the approximate percentage of decline. It is hardly a pretty picture.

When one considers that these 30 stocks (and others of their caliber) make up the backbone of many of the leading trust, pension, college and other funds in the nation, one can get some idea of the important and frightful losses which have been incurred.

Note the date for the various all-time highs in the Dow stocks. Can anyone doubt that the best policy has been to "get out" when the Dow theory gave its warning signals during 1966? How many men do you know who were smart enough to kick out each issue at or near its all-time high? And how many do you know who have been ignorant enough to ride all their stocks down as this bear market progressed (they probably still own all their shares).

STOCK	ALL-TIME HIGH	MAY 15, 1970 PRICE	% of DECLINE
Allied Chem.	66¼ (1961)	18	72%
Aluminum	133½ (1956)	57	56%
Amer. Brands	55 (1961)	32	42%
Amer. Tel.	75 (1964)	46	29%
Anaconda	66¼ (1968)	25	62%
Beth. Steel	59 (1959)	26	56%
Chrysler	73 (1968)	23	68%
du Pont	294 (1964)	108	62%
Eastman Kodak	87 (1969)	66	24%
Gen. Elec.	120 (1966)	66	45%
Gen. Foods	108 (1962)	73	32%
Gen. Motors	114 (1965)	63	45%
Goodyear	34 (1969)	23	32%
Int. Harvester	53 (1966)	24	54%
Int. Nickel	48 (1967)	39	26%
Int. Paper	48 (1959)	30	37%
Johns-Manville	44 (1968)	27	38%
Owens-Illinois	81 (1968)	43	52%
Proctor & Gamble	112 (1969)	92	18%
Sears	77 (1965)	55	28%
St. Oil of Calif.	78 (1966)	40	49%
St. Oil of Jersey	93 (1964)	52	44%
Swift	36½	24	34%
Texaco	45 (1967)	25	44%
Union Carbide	76 (1965)	33	56%
United Aircraft	122 (1967)	28	78%
U. S. Steel	109 (1959)	34	68%
Westinghouse	79 (1967)	61	22%
Woolworth	44 (1969)	27	38%

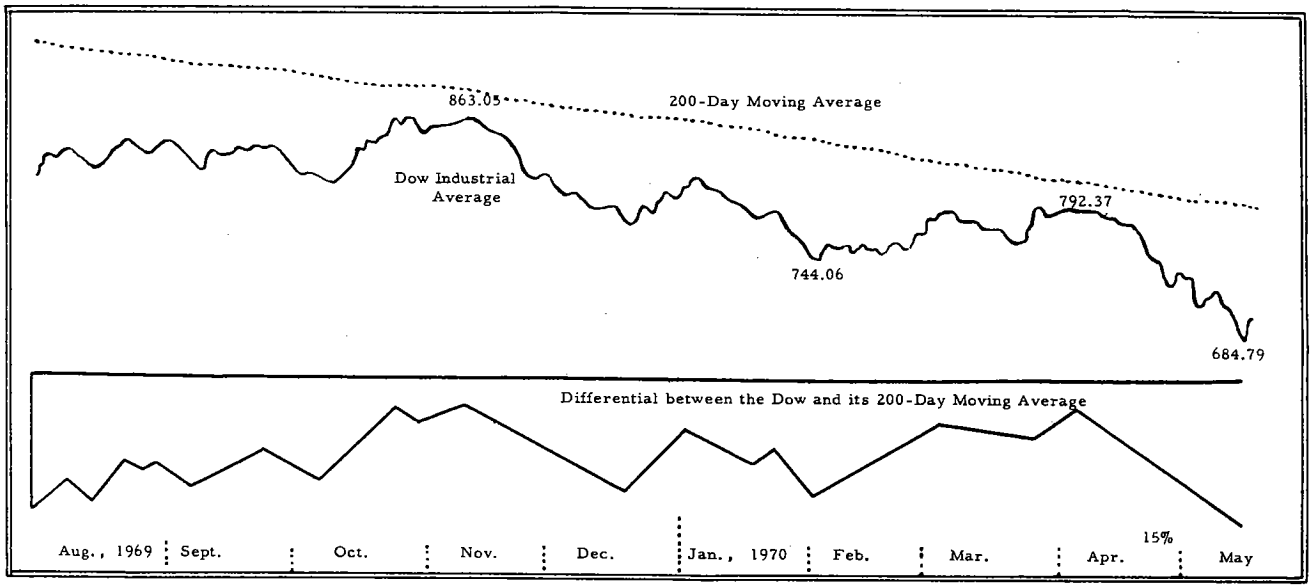
I have always held that the best market policy is to invest with the primary trend as interpreted under the Dow Theory. When a bear market starts we sell out, hold cash and wait (years if need be) until the bear market touches its final lows. That is the position the great majority of my subscribers are now in. We will sit and watch this bear market unfold through its three phases and many downward legs until our studies tell us that the worst has been fully discounted.

The identification of a bear market bottom entails many considerations including duration, extent, yields, values, psychology, volume, reaction of the market to news, level of speculation. As we get closer and closer to the ultimate bottom of this great primary bear market I will spend more and more time on our methods for identifying the final, "fortune-building" bottom. In the meantime, our job is to wait "with the patience of ten men" (as Charles Dow put it). And it is well to remember that the great fortunes are made by those who have the patience, courage and intelligence to wait through the long night for the arrival of the new day.

MORE ON THE MOVING AVERAGE: In recent Letter 459 I presented a detailed analysis of the D-J Industrial Average and its 30-week moving average. If you study any primary advance or decline of the past you will note that each has its own individual characteristics. Those characteristics can change, and it is well to be aware of when and how those changes develop. One of the best ways of studying the characteristics of a primary movement is through the relationship of the Dow and its moving average.

The accompanying chart on page 3 traces the Dow Industrials and the 200-day moving Average (a 30-week moving average can be used with almost identical results). On the bottom section of the chart we see a graph showing the differential between the Dow and its moving average. This differential can be measured daily or (as I have done here) from each successive rally and decline point. The measurements can be obtained easily, simply be taking a pair of dividers and measuring off the distance between the Dow and the moving average and then recording that distance above or below a horizontal line as shown on the chart.

The Dow broke below its moving average in May, 1969, and it has not since been able to push above the sinking moving average line. By August, 1969 (this is where the chart begins) the Dow had sunk almost 15% below the moving average. This proved to be the "strain" point, and the Dow then rallied to 863 in November, which put it only 3% under the moving average. Again the Dow declined, this time to 744.06 in January, 1970. That put the Dow about 12% under its moving average which was about 845 at the time. A new rally carried the Dow back to 792 in April, again about 3% under the Dow. The Industrials turned down again.



The most recent decline took the Dow to 684.79, just short of 15% under the moving average, which stood at about 800 at that time. The moving average is now dropping about 5 points a week and stands at roughly 790 at this writing. If the Dow "decides" to correct back towards the moving average, it could easily rally back to within say 3% of the moving average as it did during November and April. If this occurs within the next month the Dow could push to around 750 during June.

But I want to emphasize that this study should not be used as a predictive device. It should rather be used as a gauge of whether the Dow is retaining its recent characteristics or whether the movement is changing its characteristics. It is perfectly possible that the Dow will plunge down again, surpassing the 15% differential between the moving average and the Dow. In that case we could say that the character of the bear market is changing, and the decline is reaching new heights of severity. When that occurs we will want to know about it with facts. For instance, if the Dow starts sinking to 20% or more below its moving average we will be aware that the whole rate and manner of descent since late-1969 is changing to something more painful than anything yet seen.

A-D RATIO: Here is a chart (page 4) which I have wanted to construct and publish for a long time. The chart shows the semi-annual high and low of the advance-decline ratio from 1919 to date (together with the semi-annual high and low for the D-J Industrial Average). In other words, each bar on the chart connnects the high and low point of each indicator for a six month period. Each year is made up of two bars, the January through June high and low, and the July through December high and low. I constructed the chart this way in order to include all the data from 1919 to date on a single chart.

I think it is particularly interesting to compare the 1926-1932 period with the period of 1956 to the present. The A-D ratio touched its peak in 1926, then rolled over as the Dow roared up to its final speculative peak of 381 on September 3, 1929. But that final amazing advance in the Dow built up a vacuum between the Dow and the rest of the market (as represented by the A-D ratio). When the vacuum was filled (during 1929 to 1932) the Dow and the general market smashed to phenomenal lows.

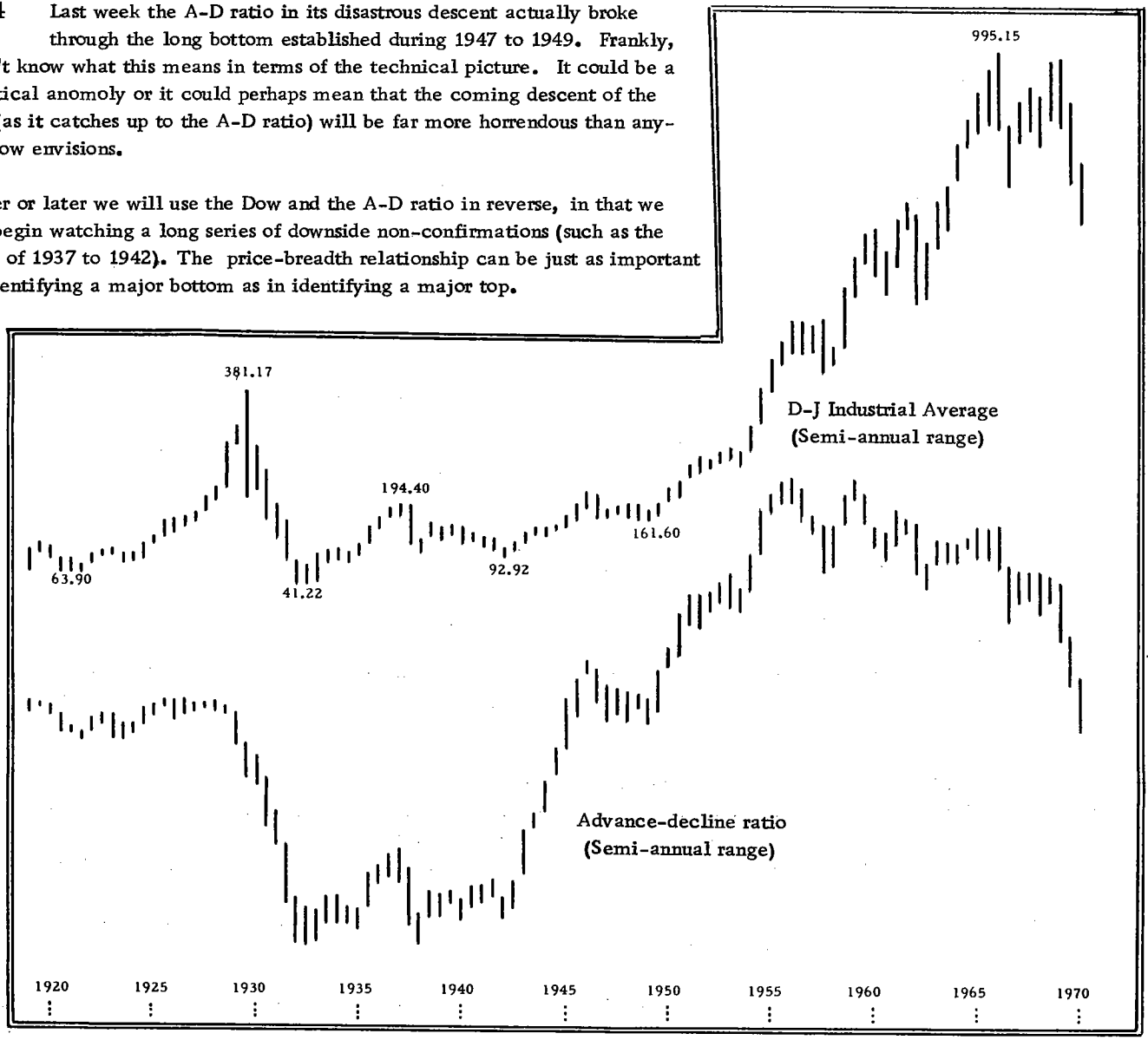
The rise in the ratio which began in 1949 touched its peak in 1956. Again the Dow advanced, but the A-D ratio (on a long range basis) began trending down. The vacuum built to greater and greater proportions. Finally, during 1969 and early 1970 the A-D ratio literally fell apart with the Dow tumbling as the vacuum began the process of being filled.

Now two bear markets are exactly alike, and no one knows whether the price-breadth relationship of 1926-32 is going to resolve itself in exactly the same way as the price-breadth relationship of 1956 to date. So far, it must be admitted, the similarities in the two periods are striking.

During 1929 to 1932 the Dow caught up to the A-D ratio on the downside, and the final bottom in 1932 saw the Dow actually 20 points below the 1921 level, the level at which the entire bull market had begun. A comparable performance now would see the final Dow low below the 161.60 low of June, 1949. Whether such a disastrous performance is possible no one knows. We can only hope that the current drastic vacuum under the Dow will not result in anything like a repeat performance of 1929.

Last week the A-D ratio in its disastrous descent actually broke through the long bottom established during 1947 to 1949. Frankly, I don't know what this means in terms of the technical picture. It could be a statistical anomoly or it could perhaps mean that the coming descent of the Dow (as it catches up to the A-D ratio) will be far more horrendous than anyone now envisions.

Sooner or later we will use the Dow and the A-D ratio in reverse, in that we will begin watching a long series of downside non-confirmations (such as the series of 1937 to 1942). The price-breadth relationship can be just as important for identifying a major bottom as in identifying a major top.



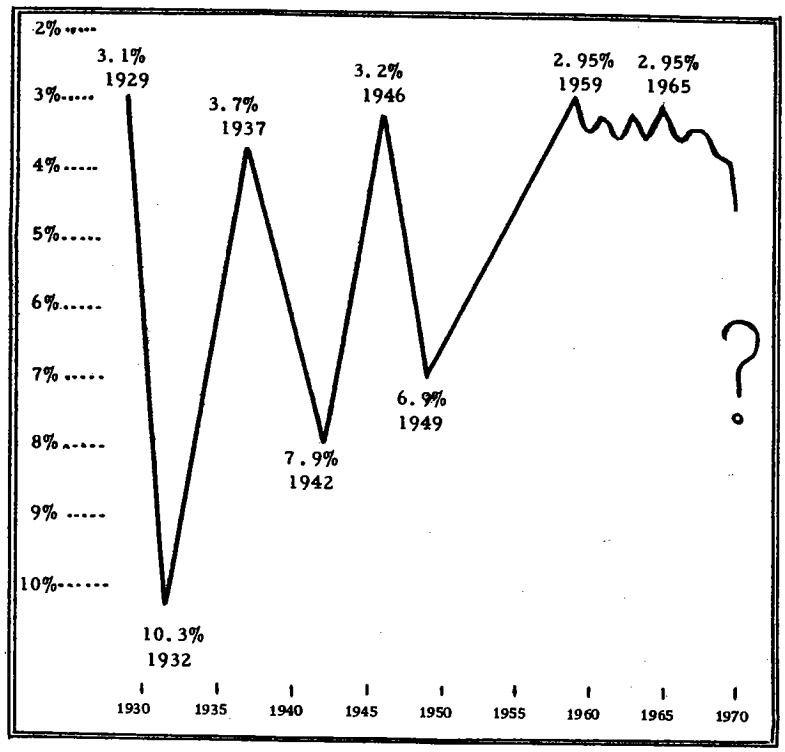
If history repeats, when the final bottom area is reached, we will get an extended series of movements in which the Dow penetrates to new lows while the A-D ratio refuses persistently to confirm.

YIELDS: One of the backbones of the Dow Theory is the study of values. During a great bull market stocks rise, and in the ultimate frenzy of the bull market top stocks go far above known values. During a primary bear market stock go down, and in the final stages of depression stocks go below known values.

The above statement seems simple, almost naive. Yet it represents a truth which has, so far, never been disproved. "To know values," Charles Dow stated, "is to know the meaning of the movements of the market." When is a stock expensive or selling above value? It is easier to answer this on an average yield basis, and in the Wall Street Journal (1902) Dow observed, "When a stock sells at a price which returns only about 3½% on the investment, it is obviously dear, except there be some special reason for the established price. In the long run, the prices of stocks adjust themselves to the return on investment, and while this is not a safe guide at all times, it is a guide that should never be laid aside or overlooked."

I have drawn a chart (page 5) showing the great yield cycles (based on the yield on the Dow Industrials) from 1929 to date. Note that Dow's "rule" has stood the test of time. All the major bull markets since the early-1900's have topped out with the Dow yield under 3½%. Following the bull market peak, the great yield pendulum swings the other way, and stocks drop to the area of "great value".

The three bear market bottoms since 1929 have all seen average yields on the Dow rise to 6.9% or better. It should be remembered that at the bear market bottom many dividends have been reduced or eliminated, so that average yields on the Dow of 6.9% or better implies a major collapse in the stock market. For this reason, we cannot say at this time that if the Dow drops to where



average yields on the 30 stocks are 6%, the Dow will therefore be at such and such a level. We simply do not know what dividend changes will occur as this bear market progresses. As a rough gauge, based on today's $31.50 annual dividends on the Dow, we can say that at 500, the Dow would be yielding 6.3%, which is less generous than any of the other major bottoms since 1929. At about 450 the Dow would yield approximately the 6.9% which it yielded in 1949.

It should be remembered that the yield cycle does not pin-point timing nor does it pin-point the exact termination of a bull or bear cycle. But it does provide a time-tested reference "zone" with which to aid us in our study of phases. Thus, I would say that as, if and when the Dow enters the zone where average yields are 6% or better, it will be an indication that we are in the third or final phase of the bear market. The farther above 6% average yields climb, the farther blue-chip stocks will have sunk below known value. As the 6% yield zone is entered we will start using all the art and experience at our command in an attempt to identify the final bottom area. There, regardless of talk, rumors, conditions or fear-psychology, we will begin accumulating stocks for the next primary bull market.

Incidentally, in the next Letter I hope to publish a fascinating chart I have been working on showing the trend of dividend increases (and resumptions) and reduction (and omissions) since 1961. That chart will tell us alot about what to expect before this bear market is over.

NOTE: Each day I receive many (and often fascinating) letters from subscribers regarding the market, the economy and news events. I could not possibly gather 10% of this information myself, so I consider myself the recipient of vital and highly interesting information from thousands of trained observers. I do not have time to thank each sender personally, but I want to take this opportunity to thank all my loyal subscribers now. I certainly appreciate all the material sent here each week.

Incidentally, the number of subscriptions to Dow Theory Letters is now the highest since I started this business in 1957. From what I understand, most of the investment advisory and brokerage businesses are in shambles. I have done my best to beg, cajole, threaten and instruct my subscribers to stay out of this tragic bear market. I would guess, from the responses to renewal subscriptions and the influx of new subscribers (many on a referral basis) that readers of the Dow Theory Letters are in as good shape financially as any single group in the nation.

I know what it means to a man to avoid the loss of a part or all of his business or his life savings. I know the frustration and fear that can overtake a man as he sees the results of a lifetime in savings wiped out by a vicious and extended bear market collapse. I know that much of what I write is difficult to believe, I know that much of it requires many hours of study to comprehend. I have always tried to present the truth as I know it, and that truth is often hard to accept during a bear market.

So if you have operated successfully and according to Dow Theory precepts over the past few years, congratulate yourself on a job well done. For every advisor who was telling the true story, there were twenty who were issuing pap and nonsense because that's what was easiest to sell. I am always pleased (and often amazed) at subscribers who took me seriously about the "coming bear market". The fact is that I feel there is something "special" about my subscribers, and I guess what I want to say during these difficult times is "Thanks, and God bless you all."

LATE NOTES: As this is written (Wednesday, May 20) the Dow is near new lows, and this week threatens to become the eighth consecutive week of decline for the Averages. If so, it will equal the record string of eight consecutive weeks of decline during early 1932. People are beginning to realize that this bear market is in the process of correcting a quarter

of a century of deficit spending, the mountainous debts of World War II, the Korean War and the Vietnam War, the idiocy of Neo-Keynesidan "economists" who have led the nation to the brink (if not over the brink) of insolvency, and a stock market which indulged in a speculative bull market third phase lasting nine years (1958 to 1966).

For these reasons, it is probable (and it is happening) that a multitude of records are going to be set on the downside, as the bear market corrects history's greatest bull market and economic binge.

NOTES AND QUOTES: I don't always agree with Harvard economist John Kenneth Gailbraith, but I thought the interview with him in a recent issue of the New York Times was particularly interesting. I include a bit of it here.

"What alarmed me were a couple of articles on James Ling [head of Ling-Temco-Vought] in Fortune, in which he talked about his theory of redeploying funds," said the professor.

"The madness is thinking that people who combine corn starch factories with sporting goods factories with aviation plants are geniuses. The madness is thinking that men who start a mutual fund and hire salesmen and then hire themselves to manage the fund are geniuses. The madness is having a hedge fund with one man who knows which stocks will go up and another man who knows which will go down."

Professor Galbraith recalled the late Fred Schwed's tale of the visitor to New York who was shown the harbor with its brokers' yachts and bankers' yachts. The visitor asked: "Where are the customers' yachts?"

Said Professor Galbraith: "I've had exactly the same reaction every time I've read of Bernie Cornfeld's moving from one mansion to another in one airplane or another with one set of girls or another. The question now to be asked is, 'Where are the customers' girls?'

Leverage Works 2 Ways

"I.O.S.'s Fund of Funds is an almost exact reproduction of an earlier piece of insanity —that you can multiply financial genius by investing in other geniuses. What wasn't noticed in 1929 and what is not noticed now is that leverage has a multiplying effect not only in a rising market but also in a declining market.

"One should now take the famous comment about the brokers being 'the men who took my fortune and ran it into a shoestring' and transpose it to the go-go funds."

"When I see road company operators billing themselves to the public as the greatest financial geniuses since the Rothschild family, I get a great satisfaction from realizing that circumstances will reduce them to normal," said the professor.

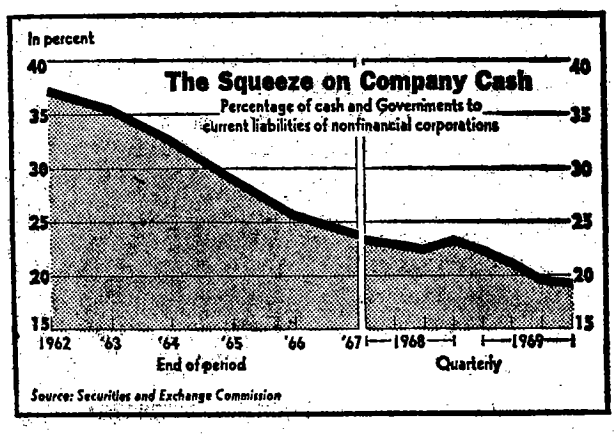
"As life closes in on someone who has borrowed far too much money on the strength of far too little income, there are no fire escapes. After 1929 it was remarkable how they drifted into obscurity—the Meehans and Hopsons and Cuttens and Durants."

FUND INDEXES

Following are Arthur Lipper & Co. mutual fund indexes, including reinvestment of all distributions, for the week:

No. & Type of Funds		Per Cent Change Year to May 14	Week Ended May 14
457	All Funds	—22.38	—5.09
296	Growth	—27.22	—5.65
90	Growth & Income	—16.23	—4.59
24	Balanced	—12.53	—3.81
42	Income	— 7.64	—2.88
5	Bank & Insurance	—17.94	—5.02
	* * *		
Dow	Industrial 684.79	—14.44	—5.29
S & P	500 75.44	—18.05	—5.50
S & P	425 82.47	—18.74	—5.62
NYSE	Composite 41.37	—19.72	—5.66
Amex	Index 20.95	—20.25	—3.68

CHART OF THE MONTH: Here is a chart showing corporate liquidity during the 1962 to 1970 period. If you mentally superimpose the Dow Industrials over the declining line on this chart, you will see how the market was going up while corporations were running into the worst liquidity position in memory. To "undue" this squeeze, it is going to take new bond offerings, lowered expenses, and probably an economic slump. During the painful period, cash is going to be king.



Finally, this week's humor. This little squib tells about Nahum, who was long-term bullish on the auto industry and also foresaw the pollution problem. They say he harbored mixed feelings on the future of civilization during the 1970's.

Prophet 'Predicted' Modern Automobile

ROME (NEA) — Nahum, the ancient Biblical prophet, seems to have foreseen the coming of the automobile.

Some 2,500 years ago, he stated: "The chariots shall rage in the streets, they shall jostle one against another in the broad ways; they shall seem like torches, they shall run like the lightnings."

LATE, LATE NOTE: (Thurs. morn, May 21). Yesterday, all three Dow Averages broke to new bear market lows, thus revitalizing the bear forces in one of history's most relentless declines. It is incredible that an all-out crash has been averted for so long. The bear market appears to be feeding on itself now, with margin calls, more and more potential sellers and an increasing number of red-faced analysts who are learning that an "oversold" condition in a primary bear market bears no resemblance to 1957 or 1962.